E COPY

Office-Supreme Court, U.S.
FILED
APR 2 1965
JOHN F. DAVIS, CLERK

No. 899

In the Supreme Court of the United States

OCTOBER TERM, 1964

MURPHY OIL CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

ARCHIBALD COX,
Solicitor General,
LOUIS F. OBERDORFER,
Assistant Attorney General,
MELVA M. GRANEY,
THOMAS L. STAPLETON,
Attorneys,
Department of Justice,
Washington, D.C., 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 899

MURPHY OIL CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

This case concerns the proper treatment, for income tax purposes, of a lease bonus paid in connection with the acquisition of oil and gas leases in three tracts of land. The taxpayer-lessee has contended that an aliquot part (the portion allocable to the taxable year, $181,880) of the lease bonus paid by it as lessee is (1) excludible from its gross income in determining taxable income and, if not, then that (2) it must be included in its percentage depletion base (its gross income from the property). The decision below rejecting both contentions is in accord with the pertinent Treasury Regulations and decisional law.

Under the pertinent Treasury Regulations, production income in the amount of the lease bonus is in-

768-774—65

cluded in the lessor's depletion base and excluded from the lessee's depletion base (gross income from the property). Treasury Regulations 118 (1954 Code), Sections 39.23(m)-1(e)(5) and 39.23(m)-10 (a) and (b). On the other hand, unless the lease bonus is an advance royalty (as representing a required payment on a specified number of units annually, not true in the present case), it is a capital investment as to the lessee. *Ibid.* As such it cannot be deducted from the gross income received by the lessee (which includes the amount of production income included in the lessor's depletion base). Thus, the result is that, although an amount of production income equal to the lease bonus must be excluded from the lessee's depletion base for percentage depletion purposes, that amount nevertheless constitutes taxable income to the lessee. This conclusion may seem anomalous, but it is required by long standing Treasury Regulations and was approved by two different circuits even prior to the decision below by still another circuit.[1] *Sunray Oil Co.* v. *Commissioner,* 147

[1] Inherent in the rule so established is the fact that although both parties, as here, have realized income in the amount of the lease bonus—the lessor from the bonus itself and the lessee from actual operations under the lease—only one depletion deduction can be given on a given unit of oil production. The Commissioner, under a statutory grant of authority calling for an apportionment of the depletion allowance between lessor and lessee, has allocated the allowance on that part of production represented by the amount of the bonus to the lessor; consequently, since the lessee cannot also take depletion on these same units, it must subtract this amount from its base for percentage depletion purposes. Internal Revenue Code of 1939, Section 23(m); Treasury Regulations 118 (1954 Code), Section 39.23 (m)-1(e)(5).

F. 2d 962 (C.A. 10th); *Canadian River Gas Co.* v. *Higgins,* 151 F. 2d 954 (C.A. 2d). See also *United States* v. *Dougan,* 214 F. 2d 511 (C.A. 10th); *Shamrock Oil & Gas Corp.* v. *Commissioner,* 35 T.C. 979, now pending on appeal to the Fifth Circuit. Not only have the courts rejected arguments that the Regulations are invalid; it has also been noted that the type of argument advanced by the present taxpayer amounts to saying that the lessee is entitled to a double depletion allowance—one through percentage depletion and another through cost depletion (amortization of lease cost, the lease bonus). See *Sunray Oil Co.* v. *Commissioner, supra,* at 966, 967.

To avoid the outstanding decisions, the taxpayer has argued that those decisions were invalidated by two sentences contained in this Court's opinion in *Burton-Sutton Oil Co.* v. *Commissioner,* 328 U.S. 25, 27, *i.e.,* "If they are capital investments to one, they are capital sales to the other. If they are rents or royalties paid out to one, they are rents or royalties received by the other". These sentences were contained in a preliminary portion of the *Burton-Sutton* opinion explaining the Court's reasons for granting certiorari and that case did not involve a lease bonus. Thus, the court below (Pet. B–2), like the trial court before it (Pet. A–7), was not convinced that the two quoted sentences changed the law as announced in the *Sunray Oil* and *Canadian River Gas* cases. For the same reasons which support that view, there is no merit in the taxpayer's assertion here (Pet. 6, 10–11) that the decision below is in conflict in principle with *Burton-Sutton.*

There also is no basis for the taxpayer's assertions of other conflicts in principle with decisions of this Court. Contrary to the taxpayer's statement (Pet. 10), *Burnet* v. *Harmel,* 287 U.S. 103, did not hold that a lease bonus is an advance royalty to the lessor. *Anderson* v. *Helvering,* 310 U.S. 404, is simply an application of the "economic interest" test for determining whether a sale occurred (see, *e.g., Commissioner* v. *Southwest Expl. Co.,* 350 U.S. 308), a test which was first enunciated in *Burnet* v. *Harmel, supra,* and *Palmer* v. *Bender,* 287 U.S. 551.

There is no real conflict between the decision below and that of the Fifth Circuit in *Lambert* v. *Jefferson Lake Sulphur Co.,* 236 F. 2d 542. That case involved the question whether the taxpayer, the owner of sulphur rights under a contract, was entitled to a deduction for fixed rentals payable periodically during the primary term of the agreement. The District Court held that the payments were not delay rentals but accepted the taxpayer's contention that they were excludible from gross income as being advance royalties. On appeal, the Fifth Circuit stated that the District Court "reached the correct conclusion on the grounds assigned by it as its basis" (*id.* at 546) but based its affirmance primarily on the entirely different ground that "the payments in question were in the nature of delay rentals" and therefore deductible as rent. In brief, the government's position was rejected on the ground that the payments were true rental payments rather than a lease bonus. Moreover, since the factual conclusion that the payments were delay rental payments was directly contrary to the District Court's

holding, it is apparent that the Fifth Circuit did not truly approve the basis of the District Court's decision.

The claim of conflict apart, the issue does not have sufficient importance to warrant review. The question presented is answered by long-standing Treasury Regulations, as the taxpayer concedes, and the taxpayer offers no ground for a holding that those Regulations are invalid. The argument that it is unfair to treat a lease bonus one way as to the lessor (as income) and another way as to the lessee (as a capital investment) is answered, as the Tenth and Second Circuits long ago recognized in *Sunray Oil* and *Canadian River Gas,* by the fact that it is not at all unusual for a payment to be a capital investment as to the payor and income as to the payee.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
LOUIS F. OBERDORFER,
Assistant Attorney General.
MELVA M. GRANEY,
THOMAS L. STAPLETON,
Attorneys.

APRIL 1965.

U.S. GOVERNMENT PRINTING OFFICE: 1965